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Letter Ruling 03-6: Personal Tax Treatment of Certain Advanced Refunding Bonds

June 5, 2003

You request a letter ruling regarding the Massachusetts personal income tax treatment of interest income resulting from the planned issuance of certain advance refunding bonds referenced above (the "Bonds"). For the reasons stated below, we rule that interest paid on the Bonds will be taxable to bondholders under General Laws, chapter 62.

FACTS

The Bonds are being issued by the Commonwealth of Massachusetts as general obligations as to which the Commonwealth's full faith and credit are pledged to the payment of the principal and interest.

You state that the Commonwealth is about to issue bonds in the approximate amount of \$1,300,000,000. Approximately \$300,000,000 of these bonds will be used to finance various capital expenditures of the Commonwealth, and approximately \$1,000,000,000 of these bonds will be used to refinance outstanding general obligation debt of the Commonwealth in order to take advantage of lower interest rates in the current market.

The proposed refinancing includes what are known as advance refunding bonds, defined under federal tax law as bonds "issued more than 90 days before the redemption of the refunded bond." Internal Revenue Code of 1986, as amended ("IRC" or the "Code"), § 149(d)(5). While bonds issued by the Commonwealth are ordinarily tax-exempt for federal income tax purposes pursuant to IRC § 103, the Code allows state or local bonds only a single tax-exempt advance refunding. IRC § 149(d)(3)(A)(i). Because certain of the outstanding bonds to be refinanced in the transaction described above were themselves advance refunding bonds, the Bonds, which are being issued to refinance those prior advance refunding bonds, will be taxable for federal tax purposes. *Id.*

While the actual amounts of the new bonds described above are subject to change, it is anticipated that the taxable portion of this transaction, that is, the Bonds, will be approximately \$30,000,000.

DISCUSSION

A. Applicable Massachusetts General Laws

For income tax purposes, Massachusetts gross income is federal gross income as defined under the

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Code as amended on January 1, 1998 and in effect for the taxable year ("1998 Code"), with certain modifications. G.L. c. 62, §§ 1, 2. [\[1\]](#) Thus, all amounts which are excluded from federal gross income under the 1998 Code will be excluded from Massachusetts gross income unless a specific Massachusetts statutory modification adds the amounts back into Massachusetts gross income. Conversely, all amounts which are included in federal gross income under the 1998 Code will be included in Massachusetts gross income unless a specific Massachusetts statutory modification subtracts the amounts from Massachusetts gross income.

In general, federal gross income includes interest. IRC § 61(4). However, except as provided in IRC § 103(b), federal gross income does not include interest on a State or local bond. IRC § 103(a). Thus, interest on obligations issued by the Commonwealth that is excluded from federal gross income under IRC § 103(a) is likewise excluded from Massachusetts gross income under G.L. c. 62, §§ 1, 2. [\[2\]](#)

If a state or local bond comes within one of the following exceptions at IRC § 103(b), interest on that bond is not excluded from federal gross income:

1. private activity bonds, unless they are also qualified bonds within the meaning of IRC § 141,
2. arbitrage bonds within the meaning of IRC § 148, or
3. bonds that fail to satisfy the requirements of IRC § 149 regarding registration, federal guarantees, source of tax exemption, advance refunding, information reporting, and pooled financing.

As a result, interest on obligations of the Commonwealth that fail to meet the criteria for exclusion at IRC § 103 is included in federal gross income under IRC § 61(4) and Massachusetts gross income under G.L. c. 62, §§ 1, 2. Since there is no provision in chapter 62 for subtracting federally taxable interest paid on obligations of the Commonwealth from Massachusetts gross income, such interest is taxable for Massachusetts purposes.

The Bonds are not the subject of any specific Commonwealth statute which deals with their taxability, as is the case for certain bond-issuing authorities and certain special types of Commonwealth debt not involved here.

B. Technical Information Release 80-2

In Technical Information Release ("TIR") 80-2 the Department provided guidance on the taxability of interest and gains from certain Massachusetts and United States bonds. Specific Massachusetts bonds were listed in TIR 80-2, and for each bond a determination was made as to the tax treatment of interest and gains from the sale of the bond. Without discussion of the specific provisions of chapter 62, TIR 80-2 states a general rule:

Massachusetts General Laws exempts from income taxation interest on obligations of the Commonwealth of Massachusetts, its political subdivisions, and agencies or instrumentalities of the commonwealth and its subdivisions.

TIR 80-2 is accurate as far as it goes, but it does not provide guidance on the type of bonds that are the subject of this ruling request, *i.e.* advance refunding bonds. Chapter 62 allows the exclusion of interest only where (1) it is excluded from federal gross income, or (2) it is included in federal gross income, but Massachusetts law specifically provides that it is subtracted from Massachusetts gross income. TIR 80-2 cannot alter the statutory result. See, for example, Letter Ruling 00-12, which notes that there are exceptions to the general rule at IRC § 103 that federal gross income excludes

interest derived from State and local bonds. LR 00-12, footnote 1.

CONCLUSION

Whether interest from the Bonds is excluded from federal gross income is a question of federal law. You have represented that the Bonds are not excluded from federal gross income as a result of IRC § 149(d)(3)(A)(i), and, therefore, are federally taxable under IRC § 61(4). We rule that interest from the Bonds is included in Massachusetts gross income to the extent such interest is included in federal gross income under the rules of the 1998 Code. G.L. c. 62, §§ 1, 2.

Very truly yours,

/s/Alan LeBovidge

Alan LeBovidge
Commissioner of Revenue

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[\[1\]](#) For certain provisions of the Internal Revenue Code, not relevant here, Massachusetts adopts the current Code rather than the 1998 Code. G.L. c. 62, § 1.

[\[2\]](#) Interest on federally tax-exempt Massachusetts bonds is specifically excluded from the modification which adds back interest on non-Massachusetts federally tax-exempt debt. G.L. c. 62, § 2(a)(1)(A).